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C O N F I D E N T I A L SECTION 01 OF 04 SAO PAULO 000780

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STATE FOR WHA/EPSC, INR/IAA, INR/R/AA
STATE PASS USTR FOR KDUCKWORTH
NSC FOR TOMASULO
DOE FOR GWARD
TREASURY FOR JHOEK
USDOC FOR 4332/ITA./MAC/WH/OLAC
USDOC FOR 3134/USFCS/OIO
USAID FOR LAC/AA

E.O. 12958: DECL: 09/19/2017

TAGS: ECON PGOV PINR ELAB EAGR BR

SUBJECT: DELFIM NETTO: NOT BULLISH ON BRAZIL'S ECONOMY OR
ITS POLITICAL LEADERSHIP

REF: A. BRASILIA 1745

1B. SAO PAULO 749 AND PREVIOUS
1C. 06 SAO PAULO 907

Classified By: CONSUL GENERAL THOMAS J. WHITE. REASON: 1.4(D)

SUMMARY

11. (C) Former Finance Minister Antonio Delfim Netto told CG September 17 that the Brazilian economy is all right for now despite recent market turbulence, but he has "serious doubts" about the next 5-10 years, especially if the global economy enters a down cycle. He characterized Brazil's focus on agriculture and minerals as risky, noting that the country's relatively sound fundamentals - e.g., strong reserve position, current account surplus - could disappear overnight if global commodity prices change. Delfim stressed that he had supported President Lula's re-election and sometimes advises him, but believes the President isn't fully aware of the fragility of Brazil's economic condition and that his advisors simply aren't thinking ahead or planning for contingencies. Thus, Brazil has benefited from a favorable international economy, but not nearly as much as it could have. Commenting on the country's political situation, Netto characterized the leader of the Landless Movement (MST) as a possible Brazilian Hugo Chavez. He also did not have much good to say about any of the likely 2010 presidential candidates and expressed concern that some may have populist tendencies. End Summary.

A LONG VIEW OF THE BRAZILIAN ECONOMY

¶2. (SBU) Consul General (CG) and Poloff met September 17 with former Minister Antonio Delfim Netto to discuss the current political and economic situation. Netto was accompanied by economist and lobbyist Janio Quadros Neto, the AMCIT grandson and namesake of the late Brazilian President (January-August 1961). Delfim Netto served as Federal Deputy from Sao Paulo 1987-2006 before being defeated last year in his bid for re-election. He supported President Lula's re-election in 2006 and, though now semi-retired, serves Lula as an informal advisor. Nevertheless, he is not impressed with the government's economic policy. A Finance Minister (1967-74) and Planning Minister (1979-85) under the military dictatorship, Delfim takes a long view of Brazil's economy as his 80th birthday approaches, joking at one point that since graduating from college in 1947, "I've lived through all the crises, and some of them I even produced!"

¶3. (C) "Back when Brazil was growing," as Netto referred to the "economic miracle" of the 1970s, taxes consumed 24 percent of GDP. Now the figure is 37 percent, and Netto estimated that the government spends about 3 percent of GDP on tax collection efforts. He believes the government should reduce its footprint and limit itself to those areas where it can make modest but tangible improvements, such as health care, education, and other social areas. Infrastructure development, in his view, "should be given to the private sector." Within the Lula administration, however, there is an "ideological slant" led by Dilma Rousseff, equivalent to the President's Chief of Staff, who, in Netto's words, "wants to construct a socialist state but by way of a tour through capitalism." Rousseff is in charge of the Growth Acceleration Program (PAC), which aims to stimulate the

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economy via large infrastructure projects, many of them funded by the federal government or by parastatals.

¶4. (SBU) Netto argued that the GoB's monetary policies, while effective in keeping inflation low, are hurting Brazilian industry because the high interest rates lead to currency overvaluation. The combination of a strong currency and rising wages (the minimum wage has risen by 90 percent over the past five years, pushing all salaries up) puts Brazil in a disadvantageous position vis a vis China. The high internal costs of transportation and logistics caused by infrastructure deficiencies add to Brazil's competitiveness woes. At some point, Netto predicted, Brazil is "going to hit the wall again." The country may even experience another spurt of growth, but then some external shock or crisis will swamp the country's economy, probably in the first year of the next administration (2011), he speculated, commenting that "Lula is always lucky."

GOVERNMENT IS "SURFING"

¶5. (SBU) Fundamentals are much better than in the past, Delfim acknowledged. The State has nearly USD 170 billion in reserves and a healthy current account surplus. But optimal global economic conditions represent a lost opportunity for Brazil. While countries such as India and China are booming, Brazil struggles to achieve four or five percent annual GDP growth. Many commentators give the government a "10" grade for its economic management, perhaps because of its orthodoxy, but Netto thinks it probably deserves a "3" at most. Lula's Ministers and advisors are enjoying the "miracle," surfing on the global wave, and not thinking about the country or its future. Nobody remembers the crises of the past or thinks about how to avoid or minimize the next one. (Note: The sole exception, Netto said, may be Harvard Professor Roberto Mangabeira Unger, Secretary for Long-Term Planning. End Note.) Brazil should be expanding its economy, creating jobs, reducing the tax burden, and improving management of health care and education, thus creating the conditions for sustainable long-term economic

growth.

16. (SBU) There is a dearth of serious political leadership, Netto complained. President Lula's Workers' Party (PT) is "primitive," and at its recent National Congress (ref B) demonstrated it is still in its "jurassic" phase. Netto singled out as "stupidity" a PT resolution supporting a plebiscite to revisit the 1997 privatization of mega-mining concern River Doce Valley Company (CVRD). In Delfim's view, the world has accepted the "WTO fantasy" that China will devote itself to industry, India to services, and Brazil to agriculture. At some point in the years to come, Delfim predicted, prices of metals, foodstuffs, and even petroleum will fall. What, he asked rhetorically, will happen then to the biofuels boom that Brazil is so excited about?

REFORM NOT IN THE CARDS

17. (SBU) Labor reform is not on the table, Netto observed, even though Brazil has the toughest labor laws in the world. The tax system is "a farce," and there is no hope of reforming it because it involves extremely complex questions of federalism. Since colonial times, Delfim pointed out, every revolution in Brazil was about taxation. Right now,

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Congress is considering renewal of the CPMF financial transactions tax, a "provisional measure" that has already been in place for most of the past 14 years. CPMF renewal will ultimately pass, said Delfim, because many in the Sao Paulo Congressional caucus obey Governor Jose Serra, and many Deputies from Minas Gerais are beholden to Governor Aecio Neves. The two states combined account for 123 of the Chamber of Deputies' 513 members. Both Serra and Neves are potential Presidential contenders in 2010, and it would be suicidal for them to oppose the CPMF and thus cause disarray in the nation's finances.

18. (SBU) The situation surrounding Senate President Renan Calheiros - narrowly absolved September 12 of breach of parliamentary decorum but facing several more charges (ref A)- is a "tragedy," in Netto's view, but Calheiros, though in many ways typical of Brazil's political system, doesn't really matter. What is important, he said, is who will be elected President of the Chamber of Deputies and the Senate in the 2009 session, because they will determine whether any legislation will pass. Due to the electoral calendar, Lula has a very limited period of time in which he can actually govern, and has already lost much of it to the Calheiros scandals. He will need Congressional support in 2009 to make anything happen. Following municipal elections and Congressional leadership elections, a "new power structure" will be in place as the country prepares for the 2010 presidential elections.

PRESIDENTIAL HOPEFULS

19. (C) Governors Serra and Neves, both of the opposition Social Democracy Party of Brazil (PSDB), are the only two real presidential candidates, Netto said. Lula's PT has "nobody". PT Senator Aloizio Mercadante "destroyed himself" by first trying to cut a deal that would avoid Calheiros's expulsion, then abstaining in the secret vote, and finally disclosing his vote and portraying it as an act of political principle. "He lost at least half his votes," Delfim said of Mercadante, who was elected to the Senate in 2002 by more than 10.4 million "paulistas". He also did not think Dilma Rousseff or Bahia Governor Jaques Wagner had a chance. The PT, Delfim said, will survive, but it is obvious that after Lula leaves, the party will have a leadership problem.

110. (C) Lula may try to support someone from his governing coalition, Delfim speculated, mentioning Defense Minister Nelson Jobim of the Brazilian Democratic Movement Party

(PMDB). Asked about Federal Deputy Ciro Gomes of the Brazilian Socialist Party (PSB), Netto expressed deep concern and likened him to a less intelligent Serra. While not a big fan of Governor Serra, considering him authoritarian, interventionist, and anti-business - he recalled Serra's action as Health Minister asserting Brazil's right to break patents on HIV/AIDS drugs - Netto likes Gomes even less: "Serra is scary but he knows things. Ciro is scary but he doesn't know anything and only pretends to know." Netto believes Gomes, if elected, could become "Brazil's Chavez" and would attempt to govern by populist rhetoric and outdated socialist economic principles.

¶11. (C) Though critical of Gomes, Delfim asserted that Brazil already has another, &real8 Chavez in its political life - Joao Pedro Stedile, head of the Landless Rural Workers' Movement (MST). The MST is a political organization

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that presses for agrarian reform and foments invasions of farms throughout the country. During an April 2006 visit to Curitiba at the invitation of Parana's populist Governor, Roberto Requiao, Chavez met with Stedile and militants from the MST and an affiliate, Via Campesina, calling for solidarity among Latin American social movements. Aligned with Lula's governing coalition and generally supportive of the Lula administration, the MST recently marched on the capital in order to illustrate its displeasure over what many in the MST see as Lula's abandonment of the PT's leftist principles. Stedile, Netto pointed out, is an economist, a good organizer with a gift for making people believe in him, and has control of a "paramilitary organization." (Comment: Netto did not elaborate on this last characterization, but many in Brazil's political and economic elite consider MST militants a gang of armed thugs, trained by the FARC and other revolutionary movements, and bent on taking over the country. End Comment.) Netto acknowledged that his view of Brazil's political and economic situation is pessimistic, but insisted that it is also realistic.

WHAT'S WRONG WITH THE POLITICAL SYSTEM

¶12. (C) Brazil's political apparatus desperately needs overhauling, Delfim said. The current system, in his view, is Fernando Henrique Cardoso's (FHC, President 1995-2002) worst legacy. FHC pushed to amend the 1988 Constitution to permit re-election, and, in Netto's words, "bought the vote" in Congress. Now Brazil has "re-election without social control," in which politicians own the instruments of power - newspapers, radio, and television - and use them to perpetuate their own power and influence. Proportional election of federal and state deputies is the other major problem, Netto said, arguing that it distorts the composition of Congress in favor of the evangelical churches. He supports a single-district system similar to the one in the United States.

COMMENT

¶13. (C) When we last met with Delfim Netto in August 2006 (ref C), he said he was supporting Lula because, unlike his opponent, Lula would be able to convince the PT and other leftist parties not to block badly needed reforms of the tax, social security, and labor systems. While he professes to like and admire Lula, he does not hide his disappointment: He minces no words about the economic path the government is following and sees real pitfalls in the current strategy. While some of his fears may be exaggerated (such as the MST resorting to paramilitary tactics in pursuit of redistribution of land and wealth), they are no more so than Lula's celebration of what he calls the best economic moment Brazilians have ever known. End Comment.

¶14. (U) This cable was coordinated with Embassy Brasilia.

WHITE